

Shoals Sewer Company
***Application for approval of an increase in its sewer
rates and charges***

Docket No. 2002-341-S

***Direct Testimony of
Roy H. Barnette
Audit Department***

Public Service Commission of South Carolina

1 Q. PLEASE STATE FOR THE RECORD YOUR NAME, BUSINESS ADDRESS
2 AND OCCUPATION.

3 A. My name is Roy H. Barnette. My business address is 101
4 Executive Center Drive, Columbia, South Carolina. I am
5 employed by the Public Service Commission of South
6 Carolina as an Auditor.

7 Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

8 A. Following a six year enlistment in the United States
9 Marine Corps, I received a B. S. Degree in Business
10 Administration with a major in Accounting from the
11 University of South Carolina in 1968. From 1968 to 1971
12 I was employed with S. D. Leidesdorf and Company, a
13 national CPA firm in Charlotte, North Carolina. In 1972
14 I entered the private business sector. My most recent
15 position was with Bagnal Builders Supply Co. Inc., here
16 in Columbia, where I served as Senior Vice President and
17 Chief Financial Officer from 1972 until September 1999
18 when I joined the Audit staff of this Commission.

19 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY INVOLVING SHOALS
20 SEWER COMPANY?

21 A. The purpose of my testimony is to set forth in summary
22 form Staff's findings and recommendations resulting from
23 our examination concerning the above docket. These

1 findings and recommendations are set forth in the report
2 of the Audit Department with attached exhibits.

3 Q. I SHOW YOU THIS REPORT WITH ITS ATTACHED EXHIBITS,
4 ENTITLED "COMMISSION STAFF REPORT, THE PUBLIC SERVICE
5 COMMISSION OF SOUTH CAROLINA, DOCKET NO. 2002-341-S,
6 SHOALS SEWER COMPANY." DID YOU AND THE AUDIT STAFF
7 PREPARE THIS DOCUMENT?

8 A. Yes. The portion under the Audit Department tab was
9 prepared by me and members of the Audit Department
10 Staff.

11 Q (MARK FOR IDENTIFICATION). WOULD YOU PLEASE SUMMARIZE
12 THE CONTENTS OF THIS REPORT?

13 A. As outlined in the Report's Index, Pages 1 through 3
14 contain the Staff's Analysis of the report, with the
15 remaining pages containing the Audit Staff's supporting
16 exhibits. The major portion of my testimony will refer
17 to the Audit Exhibit A as shown on page 4 of the Staff's
18 report. This exhibit is entitled Operating Experience
19 and Operating Margin. This exhibit, like all of the
20 Audit Staff's exhibits detailed in the report, utilizes
21 a test year ending December 31, 2001.

22 Q. DO YOU HAVE ANY FURTHER EXPLANATION OF EXHIBIT A?

1 A. Yes. The Audit Staff has prepared the exhibit in
2 compliance with the Commission's standard procedures as
3 to calculation of income and operating margin for water
4 and wastewater utilities. A brief description of Exhibit
5 A is as follows:

6 Column (1): Presents the Company's per book operations
7 as per the filing for the requested increase. Staff
8 verified the balances contained in this column to the
9 Company's books and records including cash receipts and
10 disbursements, bank deposit slips and vendor invoices.
11 The Staff verified all deposits for sewer revenue and
12 tap fees that were recorded in the cash receipts and
13 disbursement records and traced them to the Company's
14 copy of the bank deposits slips. Staff also verified,
15 through vendor invoices, 97% of Operation and
16 Maintenance Expense reflected in the Company's test year
17 filing.

18 Column (2): Presents details of the Staff's accounting
19 and pro forma adjustments. These adjustments were made
20 by the Staff in order to normalize the Company's per
21 book operations for the review period. The Staff's
22 accounting and pro forma adjustments are detailed
23 separately in Exhibit A-1.

1 Column (3): Presents Staff's computation of the
2 Company's normalized test year prior to showing the
3 effect of the proposed increase.

4 Column (4): Presents the Staff's adjustments for the
5 proposed increase as furnished by the Utilities
6 Department and all related tax and expense adjustments
7 that are associated with the proposed increase.

8 Column (5): Presents the Staff's computation of the
9 Company's normalized test year after giving effect of
10 the proposed increase and its associated expenses.

11 **Q. PLEASE ELABORATE ON THE CALCULATIONS IN EXHIBIT A.**

12 A. As shown in column (1), per book operations, using the
13 Company's records, the Staff computed a net operating
14 loss of (\$1). By utilizing the per book revenue of
15 \$29,437 the Staff computed a negative operating margin
16 of (24.46%) after deducting booked interest of \$7,200.

17 Column (2) shows the accounting and pro forma
18 adjustments which are presented in more detail in
19 Staff's Exhibit A-1 of this report.

20 Column (3) details per book operations as adjusted by
21 the Staff. After such adjustments, the Staff computed a
22 Net Income For Return of \$3,170. Using the adjusted Net
23 Income For Return, the Staff computed an operating

1 margin of 1.30% after allowance for imputed interest of
2 \$2,764 as computed by Staff. Staff's computation of
3 annualized interest allocated the Company's Rate Base
4 (net plant) between debt and equity based on a
5 hypothetical capital structure of 50% Debt/50% Equity
6 since the Company's actual capital structure is negative
7 equity. If the Commission decides to allow the actual
8 capital structure, Staff would recommend capping the
9 allowed interest at 100% of allocated Rate Base, or
10 annualized interest of \$5,527.

11 Column (4) details the Staff's adjustment for the
12 proposed increase and the operating expenses affected by
13 the proposed increase. The Staff increased other taxes,
14 income taxes and customer growth for the effect of the
15 proposed increase. The effect of the proposed increase
16 on Net Income For Return was computed to be \$10,092.
17 These adjustments are also detailed in Exhibit A-1.

18 Column (5) presents per book operations as adjusted to
19 normalize the test year on a pro forma basis and after
20 the effect of the proposed increase. As a result, Staff
21 computed Net Income For Return of \$13,262. Using the
22 total revenue of \$43,764 the Staff computed an operating
23 margin of 23.99% after allowance for imputed interest of

1 \$2,764 computed using a capital structure as discussed
2 above.

3 Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE OTHER AUDIT
4 EXHIBITS IN THE STAFF'S REPORT?

5 A. Exhibit A-1 details the Staff's accounting and pro forma
6 adjustments as well as the Staff's adjustments for the
7 proposed increase and the effect of the increase on
8 operating expenses.

9 Exhibit A-2 details the customer growth computation
10 made by the Staff. The Staff performed the growth
11 calculations using the formula method as detailed in
12 Exhibit A-2. The number of customers increased from 101
13 to 104 during the test year which resulted in a growth
14 factor of .97%.

15 Exhibit A-3 shows the Company's Income Statement as of
16 December 31, 2001 as detailed in the filing. The Staff
17 verified the balances contained in this statement to the
18 Company's books and records including cash receipts and
19 disbursements, bank deposit slips and vendor invoices.
20 As stated earlier in my testimony, Staff verified all
21 deposits for sewer revenue and tap fees that were
22 recorded in the cash receipts and disbursement records
23 and traced them to the Company's copy of the bank

1 deposit slips. Staff also verified, through vendor
2 invoices, 97% of Operation and Maintenance Expense
3 reflected in the Company's test year filing.

4 Q. WHICH ADJUSTMENTS ON EXHIBIT A-1, IN YOUR REPORT, ARE
5 THE RESPONSIBILITY OF THE AUDIT DEPARTMENT?

6 A. The adjustments marked with an (A) are the
7 responsibility of the Audit Department and the
8 adjustments marked with a (U) are the responsibility of
9 the Utilities Department. The adjustments that contain
10 both an (A) and a (U) denote partial responsibility of
11 both departments.

12 Q WOULD YOU PLEASE EXPLAIN THE AUDIT DEPARTMENT'S
13 ACCOUNTING AND PRO FORMA ADJUSTMENTS CONTAINED IN
14 EXHIBIT A-1?

15 A. Adjustment #2 Tap Fees - Staff proposes to remove tap
16 fee revenue of \$1,000 and related expenses of \$1,000
17 from operating revenues and expenses. The Company was
18 unable to identify expenses related to the installation
19 of taps. Therefore, Staff will remove expenses equal to
20 the tap fee revenue on the assumption that expenses
21 related to the installation of the taps are equal to tap
22 fee revenues received.

1 Adjustment #3 General and Administrative Expense -
2 Staff proposes to increase General and Administrative
3 expense by \$400 for omissions found during the Staff's
4 audit. Expenses included rent of \$100 and administrative
5 fees of \$300 for the month of July, 2001.

6 Adjustment #4 Annualized Depreciation - Staff proposes
7 to annualize depreciation expense based on year end
8 plant in service and depreciation rates recommended by
9 the Utilities Department. Plant in service was reduced
10 by Contributions in Aid of Construction (tap fees)
11 before depreciation expense of \$6,823 was computed
12 resulting in an adjustment of (\$707).

13 Adjustment #5 Taxes Other Than Income - Staff proposes
14 to adjust gross receipts tax by (\$77) using the current
15 gross receipts tax rate of .008141931 applied to "as
16 adjusted" operating revenue. The gross receipts tax rate
17 used during the test year was .011206749.

18 Adjustment #6 Income Taxes - Staff proposes to adjust
19 income taxes by \$90 based on taxable income as adjusted
20 including annualized interest expense. The effective
21 total tax rate is 19.25%.

22 Adjustment #7 Customer Growth - Staff proposes to
23 adjust customer growth by \$30 for the effect of

1 accounting and pro forma adjustments. The Company began
2 the test year with 101 customers and ended the test year
3 with 104 customers resulting in a customer growth
4 percentage of .97%.

5 Adjustment #9 Gross Receipts Tax - Staff proposes to
6 adjust gross receipts tax by \$102 for the effect of the
7 proposed increase using the current gross receipts tax
8 rate of .008141931.

9 Adjustment #10 Income Taxes - Staff proposes to adjust
10 income taxes by \$2,383 for the tax effect of the
11 proposed increase. The effective total tax rate is
12 19.25%.

13 Adjustment #11 Customer Growth - Staff proposes to
14 adjust customer growth by \$97 for the effect of the
15 proposed increase.

16 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

17 A. Yes, it does.